FEBRUARY 20, 1984

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FORTUNE

WHAT'S LEFT OF REAGANOMICS?

APPLE BITES BACK

RUPERT MURDOCH'S MOTLEY EMPIRE

THE BUSINESS ION OF NDA

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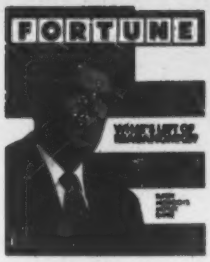

If only the dollars-and-cents promise of Reaganomics had been as enduring as the Stars and Stripes. The cover painting is by Eraldo Carugati. For an account of how Reagan missed his original economic goals, and what he might do if reelected, *see page 42.*

FORTUNE

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FORTUNE (ISSN 0015-8259), February 20, 1984, Vol. 109, No. 4. Issued biweekly by Time Inc., 3435 Wilshire Blvd., Los Angeles, Cal. 90010. Second-class postage paid at Los Angeles, Cal., and at additional mailing offices. Subscriptions: U.S., U.S. possessions: one year $39, Canada: one year $49. Address all subscriptions and correspondence concerning them to FORTUNE, 541 North Fairbanks Court, Chicago, Ill. 60611. Principal offices: Time & Life Building, Rockefeller Center, New York, N.Y. 10020. Address correspondence concerning editorial material to FORTUNE, Time & Life Building, Rockefeller Center, New York, N.Y. 10020. J. Richard Munro, President, E. Thayer Bigelow, Treasurer, Charles B. Bear, Secretary. Authorized as second-class mail by the Post Office Department, Ottawa, Canada, and for payment of postage in cash. Member, Audit Bureau of Circulations. POSTMASTER: Send address changes to FORTUNE, Time & Life Building, 541 North Fairbanks Court, Chicago, Ill. 60611. © 1984 Time Inc. All rights reserved. Reproduction in whole or in part without permission is prohibited. FORTUNE is a registered mark of Time Incorporated.

COMMUNICATIONS/ANDREW C. BROWN

EUROPE BRACES FOR FREE-MARKET TV

■ Alasdair Milne, director-general of the British Broadcasting Corp., harrumphs about the "worthless, debilitating, and mindless rubbish" on U.S. television. Other proprietors of government-backed European TV darkly warn of "wall-to-wall *Dallas*" in Europe. But viewers seem ready, even eager, to take the risk. Pulled by consumer demand and pushed by technology, European TV is rapidly becoming, well, more American.

The pace and degree of change will vary with each country's idiosyncrasies and political leanings, but the current impresarios of European TV, the government broadcasting authorities, eventually will lose their monopoly. Consumers want more televised entertainment than they're getting now, and their desires are creating potentially huge opportunities for the creators and marketers of programming. As advertising restrictions lessen, millions of dollars will pour into television. Marketers will see whether Europe can finally develop into a single mass market for packaged goods and other kinds of consumer items.

The premise of governments that television is a scarce national resource to be doled out through a handful of broadcast channels won't stand up to new technology. Satellites can beam additional TV signals to cable systems for distribution to homes. Direct broadcasting, a fast-evolving technology just getting under way commercially in the U.S., uses satellites to send signals to small, inexpensive dish antennas on consumers' rooftops. Satellite distribution to cable systems is only beginning in Europe, and direct broadcasting is somewhere in the future. But already the message is clear. Says Régis de Kalbermatten, secretary-general of the European Broadcasting Union, an organization representing public broadcasters in 31 countries: "With cable and satellites, there's no reason anymore to have a broadcasting monopoly."

European governments have tried to stay in the game by controlling the technology. At first several, including France, West Germany, and Britain, made plans to launch expensive, high-powered direct-broadcast satellites, each with up to five TV channels, by the late 1980s. Though the plans still exist, governments now are pushing sophisticated cable systems. In both cases governments are hardly out to give viewers more choice: the primary motivation is industrial policy.

MOST SATELLITE PROJECTS seem intended to give national aerospace contractors a leg up in the satellite business, where Europe lags behind the U.S. Cabling the countryside is supposed to boost telecommunications, an industry that nearly every European government has targeted as a hoped-for source of future jobs and economic growth. In many European countries the government PTTs (post, telephone, and telegraph authorities) are responsible for cable systems; once in place, high-capacity cable can upgrade national phone networks to better handle such things as two-way data communications as well as TV channels.

RESEARCH ASSOCIATE *H. John Steinbreder*

***Dallas* star Larry Hagman** *is a dreaded symbol of*

What kind of TV programming the satellites and cables are supposed to carry is sort of an afterthought, and a subject of perpetual debate. American cable systems generally offer customers a package of basic services—available channels of conventional TV broadcasts along with satellite-transmitted news, sports, pop music, and general entertainment channels supported by advertising—and one or more extra-cost "pay TV" channels consisting largely of recent feature films. As they move into cable, European officials clearly hope to retain control. But most realize that to offer enough of the kind

what European highbrows fear from an expansion of commercial TV. As his wife, Maj, watches, Hagman finger-wrestles a fan in a Munich beer hall.

of entertainment that will sell cable, they will have to rely on imported programming, mostly from the U.S.

The best evidence that Europeans want more entertainment is the phenomenal number of videocassette recorders (VCRs) they've been buying. The Economist Intelligence Unit, a London-based research organization, estimates that the number of VCRs in use in Europe grew from fewer than half a million in 1978 to nearly 14 million last year (vs. 8.4 million in the U.S.). The retail value of VCR sales reached an estimated $3.9 billion in 1982, and consumers shelled out an additional $1.2 billion for software—blank tapes and prerecorded cassettes. The Economist Intelligence Unit forecasts that by 1985 the hardware market will be worth $6 billion and the software market will hit $3.5 billion. In prerecorded cassettes, most of which are rented, the big draw is Hollywood feature films, followed by pornography. An obvious message from the hot new medium of video is that consumers have an appetite—and perhaps a lust—for a lot more than they can get by simply watching what's on broadcast TV.

Another demand not currently satisfied by television comes from advertisers. Government broadcasts in Belgium, Denmark, Norway, and Sweden carry no TV advertising. Italy, by contrast, has become one of the world's most commercial and competitive television markets; a 1976 court ruling there lifted the state monopoly's control over local broadcasting. Between those extremes, demand for ad time often exceeds supply, and the conditions under which ads are sold can be maddeningly restrictive. West Germany, for example, permits 20 minutes a day on two of its three channels—but ads can't appear after 8 P.M. Advertisers there, and in

France and the Netherlands, submit requests each fall for time the following year. Prices are fixed and advertisers have little say over where in the schedule their ads appear. "You wouldn't believe the complexities of some of the allocation systems," says Peter Curtis, research director at Michael Jarvis & Partners, a London media-buying agency. "They're heavily weighted to avoid letting the Unilevers and Procter & Gambles monopolize the time that's available. It's schizophrenic. The broadcasters protect the consumers from advertising, but they also protect advertisers from competing with each other for airtime."

In such restricted markets, a lot of money that wants to flow into TV advertising gets turned away, or doesn't bother to show up. The amount of such frustrated spending is unknowable. But it's worth noting that in the relatively free British market, TV expenditures amount to roughly 0.3% of GDP, compared with nearly 0.5% in the U.S. Ad agency executives contend that if the rest of Europe were as liberal as the U.K., and TV ad spending relative to each country's economy began to approach British levels, then total spending on European television—currently about $4 billion a year—could easily rise by $2 billion or $3 billion.

SOME OF THAT SWAG would be diverted from other media, but some would be new. "It wouldn't be a case of ad agencies tricking advertisers into spending more than they otherwise might," says John Perriss, media director at the British agency of Saatchi & Saatchi Garland-Compton. "TV is the medium of the age. The consumer finds it a sexy medium, and so does the advertiser. The motives aren't rational. But for many product categories and many brands, TV is arguably the most effective communicator, particularly if you've got a proposition that isn't very interesting. What would you say about Coca-Cola if you didn't have TV?" With freer access to TV, the argument goes, current and would-be multinational mass marketers would step up advertising to better pursue in Europe what they're looking for everywhere: higher volumes, lower costs, and the above-average margins that flow from a dominant market share and strong brand identity.

Though English is the most widely understood language in Western Europe, language differences have to some extent kept Europe from being a mass market. Five to ten years from now, technology might change that. Satellites could distribute common programming across Europe with different sound tracks for each linguistic market. The challenge for advertisers would be to come up with images that evoke the same response from people in different cultures—boy-meets-girl, mother and child, and so forth.

The pioneer in exploiting the various demands of advertisers, viewers, and cable-minded governments is Satellite Television PLC, a London company in which News Corp., the media conglomerate run by the ubiquitous Rupert Murdoch, recently acquired a controlling interest. (For more about Murdoch, see the story on page 60.) For five hours each evening—soon to be expanded to eight—Satellite Television distributes a basic service called Sky Channel to cable systems reaching more than half a million households in Norway, Finland, Switzerland, Austria, West Germany, and the U.K., and to a lone outpost in France, the 1,000-room Meridien Hotel in Paris. The channel consists of low-budget English-language entertainment unlikely to tax the comprehension of viewers who understand even a little English—pop music, sports, movies, and recycled series such as *Fantasy Island*, *Starsky & Hutch*, and *Charlie's Angels*. It's all punctuated by advertising.

Satellite Television is the brainchild of Bri-

GRAHAM FINLAYSON

SEBASTIAO SALGADO JR.—MAGNUM

Brought to You by Rupert Murdoch

In a London studio (top photo), an announcer (visible on monitor) rehearses for an evening of Sky Channel, Rupert Murdoch's satellite-distributed cable TV service. Peruvians Eduardo Pagador and his daughter Carmen (below) tune in Sky Channel at the Hotel Meridien in Paris.

an Haynes, a onetime producer for a British current-affairs TV program who spent several months in 1979 researching and producing a segment on the booming U.S. cable TV business. As Haynes recalls, "The obvious question was, could you do the same thing in Europe?" He determined that Europe had the necessary ingredients—a satellite in orbit capable of relaying TV signals, and plenty of cable systems on the ground—but that nobody had brought the two together. "As with any invention," he says, "the parts are usually just lying around."

As was the case in the U.S. before the rapid expansion of cable and pay television in the late 1970s, European cable systems were built to improve TV reception by relaying signals from central antennas to viewers' homes. Estimates vary as to how cabled Europe really is; the Economist Intelligence Unit figures that of 122 million households in Western Europe, about 25% receive television signals by some sort of cable. Systems that sometimes cover entire cities prevail in small countries such as Belgium, the Netherlands, and Ireland that pick up a lot of cross-border broadcasting.

HURTLING THROUGH SPACE 22,300 miles above the TV viewers of Europe is something called the Orbital Test Satellite, launched in 1978 for Eutelsat, an association of PTTs. The satellite was intended to relay data and voice, but as Haynes discovered, it had plenty of spare capacity and could easily handle television as well. In 1981 Haynes won permission to rent a transponder. Through the Barclays and Guinness Mahon merchant banks, he raised $8 million from investors to bankroll Satellite Television through its first year, and started transmitting in the spring of 1982. As Haynes explains his programming philosophy: "European television has hours on end of lengthy shows about how butterflies respond to light, while what people really want is a bit of cops and robbers."

From the start, Satellite Television's challenge has been to minimize operating losses while building audiences large enough to attract revenues. This involves persuading cable operators to set up decoders and dish antennas three to five meters in diameter to receive the signal, and prevailing on governments to allow it in. By last summer the company was looking for a new shot of capital, and News Corp. kicked in $7.4 million for a 69% equity stake. "Murdoch brings muscle and management to the company," says Haynes. "They say he's bought every newspaper in the world that he wants bar one, and nobody knows what that one is—maybe *Pravda*. So who better to become Luke Skywalker than Rupert Murdoch?"

Under Patrick Cox, the company's Murdoch-appointed managing director, Satellite Television recently moved from the aging Orbital Test Satellite to a transponder on the new European Communications Satellite, launched last summer. The company is seeking to bring its signal into such additional countries as the Netherlands, Sweden, and Denmark, and to add cable systems in existing markets. It wants to increase its network from 500,000 to 2.5 million connected households by the end of the year.

A legion of blue chip advertisers has tried Satellite Television, including Unilever, Coca-Cola, Wrigley, Kellogg, Polaroid, and Schweppes. So has a used-car dealer in Norway. He didn't mind reaching a lot of people in Switzerland and Finland who wouldn't buy his cars; he was taking a first-ever opportunity to reach his fellow Norwegians on TV. But revenues will remain negligible until the channel accumulates a substantial audience and can produce audience research demonstrating that people are tuning in.

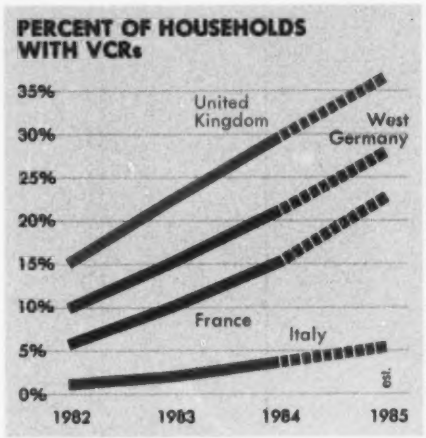
GRAHAM FINLAYSON

In a makeshift shack *in Swindon, England, a technician connects a fiber optic link carrying a satellite signal from a nearby dish antenna to Thorn EMI's 10,000-subscriber cable system.*

WHILE MURDOCH stalks the skies as a multinational cable programmer—so far without serious competition—a herd of American heavyweights has stampeded into Britain, which has emerged as Europe's most sought-after cable market. "All the wars of Europe have been fought in Belgium," says Don Cruickshank, deputy chief executive of Goldcrest Films & Television, a major British producer. "Now it looks like all the pay television wars are being fought in the U.K."

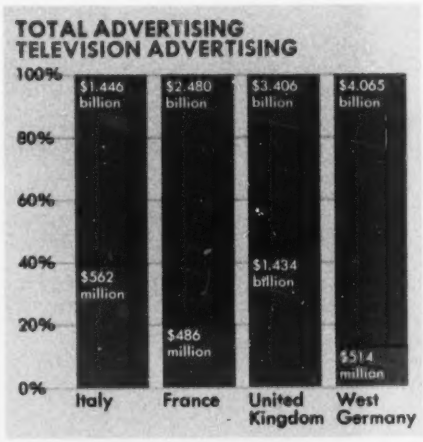
The Yankee invasion follows some fast moves by the Thatcher government to put Britain out front. The government issued interim franchises last November for new cable systems in 11 communities of up to 100,000 households each, even before the enabling legislation for cable had made its way through Parliament. Since January the government has permitted an expansion of pay TV, previously available only in a handful of trial areas, making Britain the first major European market to accept it. Over the next couple of years, other European countries are expected to permit pay TV, and U.S. companies are anxious to gain some early marketing and programming experience in their British beachhead.

The fight promises to be something of a grudge match. Home Box Office, the largest U.S. pay TV service, prospers enormously by selling a mostly-movies channel to 43% of all U.S. cable subscribers. (HBO is owned by Time Inc., the publisher of FORTUNE.) Some Hollywood studios feel that HBO throws its weight around in negotiations over rights to show films. Entering the U.K. market, the studios have split into pro- and anti-HBO camps. Columbia Pictures and Twentieth Century-Fox have banded together with HBO, while Paramount, MGM/UA, and Universal Pictures have formed a consortium called United International Pictures. The rivals plan to mar-



Turning to Tape

Europeans are spending heavily on videocassette recorders—a sign that they'll pay for cable TV entertainment when it's available. The U.K. leads Europe in VCRs; Italians lag because they have plenty of broadcast TV to watch.



The Missing Billions

A lot of cash is available for television advertising. Advertising executives estimate that if all European countries permitted as much TV advertising as the U.K. and Italy, TV would haul in $2 billion to $3 billion more a year.

ket competing pay TV channels consisting largely of recent feature films, distributed by satellite to cable operators.

The United International group has formed a company called United Cable Programmes with four British companies, which control most of the equity: Plessey, an electronics and telecommunications equipment manufacturer; the Rank Organization, a film distributor; and Britain's two largest cable operators, Rediffusion and Visionhire. Between them, their cable systems reach over a million households.

HBO, Fox, and Columbia share a 49% stake in a company whose majority shareholder is Goldcrest, a fast-growing outfit that has helped finance such recent films as *The Far Pavilions*, *Gandhi*, *Chariots of Fire*, and *Local Hero*. The partners say they're interested in bringing in additional British shareholders.

The U.S. combatants also have to fight off Thorn EMI, a British company going it alone without American partners. With revenues of $4 billion in the fiscal year ended last March, Thorn EMI is a heavyweight in entertainment: it produces films and records, owns cinemas, operates cable systems, distributes videocassettes, and manufactures, retails, and rents television sets.

The price of admission for all these programmers will be years of operating losses before cable reaches large enough audiences to attract advertisers and generate significant pay TV revenues. Nobody apparently expects to break even for the first four years, and what happens after that depends on how rapidly cable expands. CSP International, a New York-based consulting firm, projects British revenues for pay TV programmers of just $12 million to $36 million in 1987. Revenues in the U.S. were an estimated $2.8 billion last year. By 1990, though, CSP says revenues in the U.K. could rise to a range of $180 million to $300 million, and revenues for the eight largest European markets, including Britain, could be as high as $1.8 billion.

In the lean early years, programmers will be scrambling to tailor their marketing strategies to an environment quite different from the U.S., and to apply that experience to markets beyond the U.K. Two important markets on the Continent—the Netherlands and Belgium—could jell quickly. The Dutch Parliament is expected to permit pay TV this year, and many observers predict that Belgium will follow suit. Since both countries are so heavily cabled, they could generate high pay TV revenues faster than a developing market like Britain.

Prospects for commercial television in West Germany have improved dramatically since Chancellor Helmut Kohl's center-right coalition formed a government in 1982. Kohl's predecessor, Helmut Schmidt, despised television and once referred to cable TV as "more dangerous than nuclear power." Starting last year, the Deutsche Bundespost (Germany's PTT) has been allotted a $380-million annual budget to build cable systems. Programming, however, will be up to the Federal Republic's 11 states, not the central government.

KOHL'S LIBERALIZATION is luring new competitors. The German publishing giant Bertelsmann (1982 revenues: $2.6 billion) is following what its president, Mark Wössner, calls "a policy of small steps" into the programming business. Along with several other publishers, Bertelsmann has applied for a transponder on the European Communications Satellite to distribute as yet undetermined programming to West Germany's new cable systems. And on January 2, a venture called RTL Plus, in which Bertelsmann has agreed to take a 40% interest, began broadcasting a German-language TV service from Luxembourg to a potential audience of around 1.5 million households in Germany.

In television, as in other things, the French and Italians have their own way of doing things. French President Francois Mitterrand's government is committed to investing $1 billion between 1983 and 1985 to build cable systems to 1.4 million homes, employing sophisticated fiber optic cable wherever possible. From 1985 into the 1990s, current plans call for the cabling of about one million additional homes per year. While foreign programmers are not barred, the government is trying to sew up the pay TV business through Havas, the state-controlled advertising agency, which it has authorized to set up a feature film channel. Italy has been sidetracked from the new media technology by the 1976 court ruling that spurred a proliferation of local over-the-air TV stations. There are now about 250 of them; the abundance of choice they offer has squelched demand for VCRs and kept cable on the shelf.

The French market could loosen up, of course, with a change in government. In Italy viewers are showing early signs of getting fed up with advertising, which suggests an upbeat future for pay TV. In any country, technological or political development could send television off in unexpected directions. But the fundamentals are in place: strong consumer interest and impressive advertising potential. And that makes a commercial package strong enough in the long run to overwhelm opposition based on fears of an onslaught of wall-to-wall *Dallas*.

■ Though it will take years for European TV to stabilize, program suppliers are building a lot of bridges to European TV viewers. While Americans now have the most programs to sell, European suppliers will be catching up because the expanding television markets are in their own backyards. Mass marketers—particularly those that have long dismissed European TV advertising as impossibly restricted—should consider crossing the new bridges with messages of their own, lest they find consumers tuned in to the competition. ■